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THE ROLE OF THE PUBLIC INDUSTRIAL ENTERPRISE IN BRAZIL *

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PREFACE

This study was undertaken within the framework of the research and studies programme on the role of the public sector in the industrialization of developing countries conducted by the Regional and Country Studies Branch of the Division for Industrial Studies, UNIDO. Through this research programme, an attempt has been made to analyze the role and function of the public industrial sector in developing countries and to examine the crucial issues surrounding their operations.

The country studies have primarily focussed upon the role of public industrial enterprises as instrument of industrial policy and strategy; their contribution to growth and development of the industrial sector and national economy; their operational performance as well as their organizational framework and institutional infrastructure. By examining the role of public industrial enterprises and identifying the major constraints facing these enterprises in various developing countries the uncertainties surrounding their operational performance may be reduced and a basis laid for improving their efficiency and enhancing their contribution to industrial growth and national development.

In this country study the role and function of the public industrial sector in Brazil is analyzed. The study was carried out in co-operation with Pablo Motta, Director, Brazilian School of Public Administration (EBAP), as UNIDO consultant on the basis of information and data collected through a questionnaire survey.

CONTENTS

Chapter		Page
	INTRODUCTION	1
I.	RATIONALE AND ROLE OF THE PUBLIC INDUSTRIAL SECTOR	2
	1.1. Rationale for the establishment of public enterprise in Brazil	2
	1.2. Role of public industrial enterprise	4
II.	IMPACT OF THE PUBLIC INDUSTRIAL ENTERPRISE SECTOR	9
	2.1. Investment trends	9
	2.2. Comparative performance of public and private enterprises	12
III.	ORGANISATIONAL FORMS AND LEGAL STRUCTURES	18
	3.1. Legal structures	18
	3.2. Governmental control and supervision	18
IV.	SUMMARY AND CONCLUSION	20

LIST OF TABLES

Table		Page
1.	Gross fixed capital formation 1949-75 in Brazil	10
2.	Index-numbers of value added in real terms - 1964/75	11
3.	Investment per worker in selected public enterprises - 1966-75	12
4.	Comparison between public and private (national and multinational) enterprises among the largest 200 Brazilian firms (1979)	13
5.	Value added and investment in public and private enterprises 1949-1975	14
6.	Comparison between productivity (value added by man-year) and employment in large public enterprises in the industrial sector 1966-1975	15
7.	Public and private enterprises by industrial sectors in terms of net assets and employment	16
8.	Number of public enterprises by sector (1980)	17

Introduction

The Brazilian public enterprise sector is confined to areas of infrastructure, public utilities and some key industries. The industrial sector dealing with manufacture and processing is basically private, with a strong multinational presence. Some manufacturing industries sometimes listed as public enterprises are, in fact, private ones. They are inappropriately described as public concerns for three reasons: (1) They are private enterprises with large financing from the government, especially through the Banco Nacional do Desenvolvimento Econômico - BNDE (National Bank for Economic Development) and its subsidiaries. Governmental financing agencies exercise no managerial control over these enterprises. They remain private concerns, although the majority of their capital stock belongs to the state. It is envisaged that eventually private investors will purchase back the State-owned shares. (2) They are private enterprises which, for political and financial reasons enjoy State partnership. This is the case with several companies in the Northeast functioning with financial support from the Superintendência do Desenvolvimento do Nordeste - SUDENE (North East Development Superintendency). In these instances, State participation is, in general, that of a minor stockholder, hence the enterprises cannot be ranked as concerns effectively owned by the State. (3) They are private enterprises handed over to the State, in payment of debts previously incurred. The companies thus become State controlled; the control is exercised by the official bank that granted the loans in the first place. These concerns only temporarily assume such a character, since the governmental policy aims at the re-establishment of their private status, as soon as the governmental debts are paid, or prospective buyers appear.

There are also instances of State-owned enterprises formed to solve transitory problems related to specific projects. Others survive because of political difficulties which threaten to arise following

their extinction or their transfer to a private owner. Such concerns subsist although they are deprived of clear official support and, in fact, are practically paralyzed.

There are, finally, several mining companies established to guarantee official exploitation of natural deposits of ore, but that in reality are non-operational, serving only to preserve the national monopoly of the State in these areas. Nevertheless the public industrial sector has been growing during the past three decades and public enterprise has a strong position in some key industrial sub-sectors. There have been a wide variety of factors which have induced Brazil to expand the public industrial sector despite her commitment to a market oriented economic strategy. The major reasons for establishing public enterprises in Brazil are described in the next section.

Chapter I. RATIONALE AND ROLE OF THE PUBLIC INDUSTRIAL SECTOR

1.1 Rationale for the Establishment of Public Enterprise in Brazil

Public enterprises have grown rapidly in Brazil over the last thirty (30) years. Public enterprises have emerged to:

(1) supply the basic infrastructure required for economic development. Public enterprises came to fill those gaps which had not attracted the private enterprises due to the lack of economic and financial incentives. Public enterprises in this category include, for instance, steelworks and electric power plants.

(2) produce goods and services which enable the government to effectively execute its economic policies. Examples here include those banks controlled by the government such as "Banco do Brasil" and other state banks, and service utilities, such as data processing units.

(3) promote, stimulate and finance private undertakings of economic importance and projects located in depressed regions. This is

the case with "Banco Nacional do Desenvolvimento Economico", as well as other development banks created at state level.

(4) obtain advantages from economic monopoly where economic conditions do not permit the co-existence of a plurality of private and public enterprises. That is the case, for instance, with railways and other public enterprises which have to balance deficits from non-profitable regions with the surplus from more profitable ones, thus maintaining the necessary public service.

Political factors have also been important for the creation of public enterprises, mainly those concerned with strategic matters and with the exploitation of monopolistic advantages. Such enterprises have emerged to:

(1) guarantee national control of those undertakings considered strategic or vital for the security of the country. This is the case, for instance, with PETROBRAS and its subsidiaries which have emerged because of a commitment to safeguard national rights in the prospecting production and importation of oil in Brazil. Similarly NUCLEBRAS has been established to ensure national control in the nuclear energy industry.

(2) produce goods and services which require state intervention in order to guarantee broader political interests. As examples, we might mention the public enterprises concerned with transport and communications.

Public enterprises have also been created to serve administrative purposes. They have emerged to:

(1) decentralise administration through the creation of autonomous entities with effective decision making powers. The federal administration has often emphasised this and maintain that the geographic extension of Brazilian territory necessitates

the creation of public enterprises in the relatively remote regions of the country.

(2) to circumvent administrative and financial barriers and achieve autonomy, flexibility and higher efficiency. Such public enterprises have some freedom of manoeuvre vis-a-vis the central personnel administration departments and financing control authorities (Federal and State Audit Courts). The need for autonomy and flexibility was particularly emphasised at the time of the creation of the service enterprises, such as utilities concerned with sanitation, telephones, electric power, city maintenance and other services. Most of these public enterprises were under the control of departments of the Federal administration. These public enterprises have responded to the need for greater production. They are however not necessarily more efficient than departmental undertakings. Typically they have higher unit costs, although production levels are higher.

Finally public enterprises have been established for the production of subsidised goods and services for lower income groups. These are goods and services provided at prices considerably lower than those prevailing in the market. Thus the "Banco Nacional da Habitacao" and other state housing departments provide cheap housing facilities for the lower income groups within the country.

1.2 Role of Public Industrial Enterprise

In the early 1970s, public enterprises were important suppliers of basic inputs to the domestic economy and earners of significant amounts of foreign exchange. The government provided incentives for the expansion of export earnings and foreign borrowing by public enterprises. These enterprises grew rapidly during this period, favoured by monopoly conditions in several sectors, and were encouraged to invest abroad.

That is also the reason for the creation of subsidiaries of Brazilian public enterprises in other countries.

However, there has been a gradual disenchantment with the public enterprises. Their performance has not always been satisfactory: net foreign exchange earnings have, in particular, been very small. This has led the present Administration to revise its attitude vis-a-vis Brazilian public enterprise.

Today the government is committed to accelerate privatization. As expressed in two recent legal acts (July, 1981) the creation of new public enterprises is forbidden; the privatization of a great number of existing governmental companies is envisaged. According to the new policy, public enterprises must be restricted to essential infrastructural economic activities and to key industries. The restriction is in accordance with the constitutional precept that says that only in supplementation of private initiative will the State directly organise economic activity (article 170). However, presently almost 80% of all investments made by the 200 largest enterprises in Brazil belongs to public enterprises. In one of his first speeches as president-elect in January 1979, the present President of the Republic said: "I recommend to the Ministers that all necessary measures are to be proposed for the privatization of public enterprises excepting those strictly indispensable to corrections in the market system or to attend to national security needs". The extent to which the domestic public sector will actually be restricted in scope cannot yet be predicted with any degree of certainty.

Public enterprises in Brazil have emerged in a discontinuous and intermittent manner, in accordance with economic policies of the times, and sectoral directives of different ministries. They enjoyed an excessive autonomy in several areas and the fact that they did not fit into a national or even sectoral government strategy has been pointed

out by many economists and members of the Legislature. The recent report issued by SEST (Secretariat for Control of State Enterprises) gives evidence of both the excessive autonomy and alienation of the State enterprises. These enterprises have since come under control of the central planning agency.

In Brazil, State enterprises are related to the corresponding sectoral ministries and it is natural, therefore, that their proposals for investment tend primarily to express the views of the parent department. Harmonisation and co-ordination of investment programmes is achieved at a later stage when public enterprise plans are made consistent with economic policy.

In the absence of centralised institutionalised mechanisms, co-ordination between enterprise proposals is achieved through isolated decisions, in areas such as price fixation, allocation of federal resources, allotment of fiscal revenues, authorisation to establish contracts for foreign credits and even in the fixation of investment limits, by company or project. Thus the Conselho Interministerial de Precos - CIP (Interministerial Prices Council) controls prices of goods and services produced by State enterprises. The CIP's basic purpose was to avoid exaggerated transfers of cost increases so as to minimize their impact over the price index. The policies of this body has had an effect on the investment plans of public enterprises. Those whose product prices have remained stable while input prices have risen, have inevitably found expansion difficult if not impossible. On the other hand public enterprises whose output prices have been allowed to rise faster than the prices of their main inputs have accummulated vast investible resources.

As far as the allocation of foreign exchange is concerned, SEPLAN (Secretary of Planning) was authorised to grant credit applications after examining the financial implications of the proposed operation.

Due to easy availability of foreign exchange, state enterprises were encouraged to utilise that source of funds without reference to their capacity to earn or even to effectively utilise hard currency resources. In the area of internal credit control the controlling mechanism is the Comissão de Empréstimos Internos - CEMPIN (Internal Loans Commission), under the Banco Central (Central Bank). It was established in 1979. In this case the main objective was to establish limits to the public sector's access to the domestic financial system in order to avoid the generation of inflationary pressures within the economy.

Co-ordination between these mechanisms remains weak. Isolated decisions are taken without a comprehensive survey of the needs and performance of the state enterprises sector. Little effort is made to relate the public enterprise plans to national economic goals and strategies such as enhancing monetary discipline and reducing international indebtedness.

SEST (Secretariat for Control of State Enterprises) has been established to study the performance of State enterprises within the context of the national economic policy. SEST estimates total expenditures of public enterprises, analyses the sources and uses of funds available to these enterprises and evaluates the performance of each firm in the context of the performance of the entire public enterprise sector. SEST aims to assess the impact of public sector investment on growth and structural change within the Brazilian economy in as comprehensive a manner as possible. Thus it is incumbent upon the SEST:

(a) to ensure the compatibility of investment programmes of state enterprises with the National Development Plans.

(b) to ensure adequate performance in the public sector as concerns the fulfilment of its investment programmes, thus providing the private sector with better conditions for an adequate planning of its activities.

This concern with the control and the co-ordination of state companies' strategies within a national economic policy framework is of recent origin. It is to be expected that it will contribute significantly towards enhancing the efficiency of the Brazilian public enterprise sector in the near future.

The establishment of SEST is the latest in a long line of measures adopted by the Brazilian Government to improve the performance of public enterprise. These measures date back to the 1940s when the first big state enterprises in the steel mining and transport industries were established. In the 1950s a great State bank, the BNDE, was instituted to promote the needed investments for financing key and infrastructure ind tries. To exercise State monopoly of oil PETROBRAS was also created during this period. During the 1960s political and economic instability initially lead to a big retraction in private investments. However in 1964 the first State holding company - ELETROBRAS - appeared in the energy sector setting up a model subsequently applied to other sectors. The commitment to strengthen the market economy, with invigoration of Brazilian private enterprises and the attraction of foreign capital, did not lead to a decreased importance of the State business sectors. Throughout the 1960s and 1970s huge official investments in infrastructure and in key industries persisted. The State expanded its role both as a financier and an owner of industrial enterprises. The period was characterized by the establishment of huge State holding companies. State enterprises dominated the steel, petroleum refining, chemical and petrochemical branches. Joint ventures were established in the mining, transport equipment, machinery, tobacco and rubber industries. These developments have led to an expansion of the role of the State enterprise sector within the Brazilian economy. The present administration is committed to a privatization of industry and te curtailing the growth of public enterprises.

Chapter II. IMPACT OF THE PUBLIC INDUSTRIAL ENTERPRISE SECTOR

2.1 Investment Trends

Brazilian public enterprises, especially the ones operating in key industries, have proved to be useful substitutes for private initiative. Established to play an important role in the country's development in areas where private companies could not operate and which would inevitably have come under the control of foreign companies, they contributed to an acceleration of Brazilian industrial development. They did not hinder the growth of private initiative, but on the contrary supplied this sector with the basic inputs it needed to develop. They contributed also by improving the level of employment. However the large investment programmes of these enterprises fed the inflationary process in Brazil and many public enterprises were not particularly efficient or cost-effective. Despite this inability to earn profits the government continued to expand investment within this sector. As Table 1 shows the share of the public enterprise sector in gross fixed capital formation has been rising continuously. It represented 4.6 per cent in 1949. This rose to 18.1 per cent in 1965, 19.6 per cent in 1970 and 24.8 per cent in 1975. This has had an impact on value added. Table 2 shows that the index of public enterprise value added rose from 79 (1966 = 100) in 1965 to 371 in 1975. The average annual rate of growth of value added of the public enterprise sector was 16.8 per cent over the period 1964 to 1975; as against this the growth rate of total industrial value added was 10.4 per cent - i.e. 38 per cent lower than that of public enterprise. Table 3 shows that capital intensity has also been rising over the years. It almost quadrupled for the whole public enterprise set over 1966 to 1975. The rise in the investment/labour ratio has been most marked in the case of petrochemicals and railroad construction, and least in the case of steel. It must be noted that

TABLE 1

Gross Fixed Capital Formation 1949-75 in Brazil (estimated in 1,000 cruzeiros)

YEAR	LARGE PUBLIC ENTERPRISES	PRIVATE SECTOR	SHARE OF LARGE PUBLIC ENTERPRISES IN GROSS FIXED CAPITAL FORMATION
1949	1,017	21,183	4.6%
1959	35,249	307,051	10.3%
1965	1,102,723	4,991,577	18.1%
1966	1,746,626	8,237,074	17.5%
1967	2,723,678	10,121,022	21.2%
1968	3,658,530	17,334,670	17.4%
1969	4,452,544	23,227,460	16.1%
1970	7,407,937	30,398,570	19.6%
1971	10,904,400	41,343,100	20.9%
1972	15,169,068	54,628,730	21.7%
1973	22,142,237	73,562,160	23.1%
1974	35,419,846	110,235,850	24.3%
1975	52,674,045	159,878,650	24.8%

Source: Trebat op.cit.

Table 2

Index-numbers of value added in real terms - 1964/75

(base: 1966 = 100)

YEAR	MINIG	PETROCHEMICALS	STEEL	TOTAL FOR PUBLIC ENTERPRISES	% GROWTH	INDUSTRIAL REAL PRODUCT	% GROWTH
1964	30	30	46				
1965	27	96	113	79		89	
1966	100	100	100	100	(26.5)	100	(11.7)
1967	93	110	105	110	(10.0)	103	(3.0)
1968	91	131	152	134	(21.8)	119	(15.5)
1969	163	161	170	156	(16.4)	132	(10.8)
1970	208	158	198	183	(17.3)	146	(11.1)
1971	222	168	234	200	(9.3)	163	(11.2)
1972	261	183	257	231	(15.5)	185	(13.8)
1973	392	247	283	288	(24.7)	213	(15.0)
1974	465	287	291	334	(16.0)	230	(8.2)
1975	468	323	307	371	(11.1)	240	(4.2)

Source: Trebat op.cit.

TABLE 3

INVESTMENT PER WORKER IN SELECTED PUBLIC ENTERPRISES - 1966-75

(in 1,000 current cruzeiros of 1970 by man-years)

	1966/68	1970	1975
Mining	64	123	283
Steel	122	100	227
Petrochemicals	42	118	374
Communication	58	60	169
Electricity	366	368	734
Railroad	n.d.	8	67
Average for Public Enterprises	104	163	384

Source: Trebat, op.cit.

figures in Table 3 do not take into account the impact of inflation and the real rise in capital intensity is likely to be considerably lower than depicted in Table 3.

2.2 Comparative Performance of Public and Private Enterprises

The strong position of public enterprises within the economy is illustrated in Table 4. Here we examine the public enterprise's share in the net assets, revenue, profits and employment of the 200 largest Brazilian firms. 78 per cent of net assets and 47 per cent of net sales of these enterprises accrues to the public firms which provided 48 per cent of employment and appropriated 57 per cent of total profit in 1979. Table 5 shows that the public enterprise sector has been growing relatively since 1949. In that year its value added

TABLE 4

Comparison between public and private (national and multinational) enterprises among the largest 200 Brazilian Firms (1979)

	NET ASSETS		GROSS SALES REVENUES		NET PROFITS		EMPLOYMENT	
	in billion of cruzeiros	% of Total	in billion of cruzeiros	% of Total	in billion of cruzeiros	% of Total	in thousands	% of Total
Public Enterprises	2,000	77.9	814.5	46.7	97.4	57.2	630.5	48.0
Private National Enterprises	356.9	13.8	376.4	21.6	41.3	24.2	391.0	29.8
Private Multinational Enterprises	216.3	8.3	553.0	31.7	31.6	18.6	291.4	22.2

Source: Revista VISÃO, special issue 1980.

TABLE 5

VALUE ADDED AND INVESTMENT IN PUBLIC AND PRIVATE ENTERPRISES 1949 - 1975 (in 1,000 of current cruzeiros)

YEAR	VALUE ADDED PUBLIC ENTERPRISE	VALUE ADDED PRIVATE ENTERPRISE	VALUE ADDED PUBLIC/PRIVATE ENTERPRISE (%)	INVESTMENTS PUBLIC/PRIVATE ENTERPRISE (%)
1949	2.74	55.37	4.95	4.9
1955	11.61	220.77	5.26	7.1
1959	46.78	615.97	7.59	11.6
1965	1,141.09	10,813.92	10.55	22.1
1970	7,775.04	53,841.41	14.44	24.4
1975	54,396.51	280,458.20	19.40	33.0

Source: Trebat, op. cit.

and investment was less than 5 per cent that of the private sector. This proportion had risen to 19 per cent and 33 per cent respectively by 1975. Investment grew more rapidly within the public enterprise set than did employment. The capital intensity of public investment is greater than that of the private sector. On the other hand, comparing productivity trends in public enterprises with that in industry as a whole, Table 6 shows that in the period 1966-75 productivity grew more rapidly in state enterprises. In the same period, employment within the industrial sector expanded by 1.9 times while in public enterprise it grew by 1.6. This once again confirms the finding about higher capital intensity of public sector investment. Tables 7 and 8 which give the intra-sectoral distribution of public and private investment and employment, once again illustrates that public enterprises are concentrated in the technology intensive industries - particularly steel, petroleum and industrial chemicals.

TABLE 6

Comparison between Productivity (value added by man-year) and Employment in Large Public Enterprises in the Industrial Sector 1966 - 1975

(base: 1966 = 100)

Year	Work Productivity		Employment	
	Public Enterprise	Industrial Sector	Public Enterprise	Industrial Sector
1966	100	100	100	100
1970	140	131	138	111
1975	237	144	164	193

Source: Trebat, op.cit.

TABLE 7

Public and Private Enterprises

by Industrial Sectors in terms of net Assests

and Employment

	NET ASSETS (%)		EMPLOYMENT (%)	
	Public	Private	Public	Private
IRON and STEEL	72.6	27.4	59.0	41.0
PAPER and	5.3	94.7	1.0	99.0
RUBBER	7.3	92.7	3.3	96.7
INDUSTRIAL CHEMICALS (and PETRO-CHEMICALS)	34.8	65.2	9.4	90.6
FERTILIZERS	20.4	79.6	21.6	78.4
PETROLEUM (refinery)	96.4	3.6	94.2	5.8

Source: Adapted from Suzigan (1976).

TABLE 8

Number of Public Enterprises by Sector (1980)

Sector	Number
Steel	9
Paper and Celulosis	1
Rubber	1
Industrial Chemicals (and Petro Chemicals)	10
Ferlilizers	5
Petroleum (refinery)	1

Source: SEST Report, op.cit.

Note: Above numbers include only federal enterprises by main product. It does not include (1) companies which have stopped production or companies legally created but which have not yet started industrial production; (2) companies which are temporarily controlled by the government or private companies incorporated into the public asset because of debts to the government; (3) companies without managerial control by the government.

Data limitations make difficult an adequate analysis of the performance of Brazilian public enterprise. They are entrenched in some important industrial sectors - such as steel and petrochemicals. They include some of the largest enterprises in the country; hence their relatively higher capital intensity. However, firm level data is essential for evaluating the efficiency and the financial performance of public enterprises within the industrial sector.

Chapter III. ORGANISATIONAL FORMS AND LEGAL STRUCTURES

3.1 Legal Structures

Brazilian public industrial enterprises operate with the same legal structure as do private enterprises. The only legal difference is that public enterprises are created by law and sometimes receive funds from the government for specific investments. All legal enterprise regulations apply both to public and private enterprises. There are no legal operating differences among public enterprises themselves. Therefore, legal differences cannot be used as independent variables for explaining effectiveness or managerial efficiency.

The most successful organisational form in the Brazilian public sector has been the holding company. Its role in centralising external relations not only as to export and imports but also for obtaining foreign loans and investment has been crucial.

3.2 Governmental Control and Supervision

Institutional mechanisms for controlling and supervising public enterprises are established by Decree-Law 200/1967 (articles 19, 20, 25, 26, 27, 28 and 183). It stipulates that:

(1) Public enterprises are to be supervised and controlled by the specific Ministry to which they are subordinated. Ministerial supervision aims at adjusting public enterprise policy within the

sectoral integrated system of planning. Every Ministry, in its turn, is subordinated to the national planning system co-ordinated by the Economic Development Council (CDE) and the Social Development Council (CDS). The Executive Secretary of CDE and CDS is the Planning Secretary of the Presidency (SEPLAN) - the most important planning agency in Brazil. As mentioned in Part I, SEST was created in 1979. It is a special national agency for controlling public enterprises.

(2) In every Ministry there are Councils and Departments for sectoral supervision such as the National Petroleum Council or the National Steel Council. These bodies formulate specific policies for each sector involving both public and private enterprises.

(3) Public enterprises are also subject to auditing and financial control by the Tribunal de Contas (Accounting Court) which is an advisory agency of the National Congress. All public enterprises must under Law 6223/1975 and Law 6.525/78 present, through their respective Ministries, all balance sheets and financial reports demanded by the Court.

In practice, however, public enterprises have enjoyed substantial autonomy. The control by the Ministries has been formal and relatively ineffective. Nevertheless, the creation of SEST in 1979 and the present policy of privatization of public enterprises may in the future reverse this tendency. At present the government is responsible for the appointment of top management and plays an important role in determining company objectives, levels of investment and price policy. The government also plays a part in performance evaluation but the enterprises enjoy complete autonomy in determining the level, composition and trading of output, and in the purchase of technology and other inputs.

The Government has not however developed a performance evaluation system or institutionalised incentives or motivations to ensure that public enterprise management respond to government directives and attempt to attain the objectives set for the public enterprises. In general institutional developments have been few and far between. Little attention has been paid to monitoring the performance of public enterprise management. The organisational structure of the Brazilian public enterprise sector has remained largely unchanged since the early 1960s.

Chapter IV. SUMMARY AND CONCLUSION

Brazil is a country where state intervention in the economy is generally considered relatively high. Public enterprises are among the most important and largest Brazilian enterprises. Public enterprises are concentrated in the infrastructure and basic industrial sectors. Within manufacturing, public industrial enterprises are mainly of importance in the steel, chemicals and petrochemicals branches.

Most public industries - about two-thirds of the total - began as private enterprises and were later nationalised. The other third were created as a means of initiating or expanding public intervention in a specific sector. Public industries expanded in Brazil, mainly in the last 30 years, and contributed to national development, furnishing basic inputs to the economy as well as increasing employment levels. A comprehensive evaluation of state intervention in Brazil, through public enterprises, is still to be made. There is a need to focus attention on the role of public enterprises in the manufacturing sector. Studies, reports and data collected in Brazil about public enterprises have been concentrated on the traditional sectors within which public enterprises predominate, i.e. public utilities, services and the infrastructure.

Present governmental policy is towards an encouragement of privatization. The implementation of this policy, however, is likely to prove difficult Brazilian public enterprises tend to be large. Consequently, the cost

of buying an enterprise or acquiring a majority of its share capital is extremely high. Since the policy is to sell public enterprises only to Brazilian private firms it is difficult to imagine, at the moment, the possibility of large scale privatization. The Brazilian private sector faces financial difficulties and is unlikely to buy many large public companies. To allow foreign firms to control a larger part of the economy by selling it to state property will provoke serious internal political debate. Therefore, unless further structural changes occur in the social economic and political system, the policy of privatization will be implemented cautiously and pragmatically.

Public industrial enterprises will be more carefully scrutinized and controlled in Brazil. The new law forbidding expansion in the public enterprise sector may lead in the future to a stronger private sector. Nevertheless, restrictions on public enterprises will almost certainly lead to improvements in their better productivity and efficiency.

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ANNEX

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